



STATE OF WASHINGTON
DEPARTMENT OF FINANCIAL INSTITUTIONS
SECURITIES DIVISION

P.O. Box 9033 • Olympia, Washington 98507-9033
Telephone (360) 902-8760 • TDD (360) 664-8126 • FAX (360) 902-0524 • Web Site: www.dfi.wa.gov/sd

Investment Adviser Rules – WAC 460-24A
Summary of 2019 Amendments

On January 18, 2019, the Washington Securities Division adopted amendments to the investment adviser rules in Chapter 460-24A WAC. The Rule-Making Order (Form [CR-103](#)) and the text of the [Adopted Rules](#) are available on our website at <https://dfi.wa.gov/rulemaking/investment-adviser-rules-amendments>.

The rule amendments will become effective on February 18, 2019. Below, please find a summary of the rule amendments:

Definitions

WAC 460-24A-005

The definition rule at WAC 460-24A-005 provides definitions for key terms used throughout Chapter 460-24A WAC. The Securities Division amended the rule to update the definitions and improve the usability of the rule.

The amendments alphabetize the definitions section for ease of use. The amendments add definitions for “assignment,” “chief compliance officer,” and “supervised person.” In addition, the amendments move the definition of “advertisement” from its previous location in WAC 460-24A-100 to the definitions section.

The amendments revise the definition of “qualifying private fund” for clarity by incorporating the language of SEC Rule 203(m)-1 into the definition itself, rather than referring to it by reference. The amendments also revise the definition of “advertisement” to include a business card among the items identified as advertisements. Finally, the amendments make minor revisions to the definitions of “custody,” “CRD,” “IARD,” and “qualified custodian.”

Terms Deemed Similar to “Financial Planner” and “Investment Counselor”

WAC 460-24A-040

The Securities Division amended WAC 460-24A-040, the rule which sets forth terms deemed similar to “financial planner” and “investment counselor” for the purposes of the holding out provisions in RCW 21.20.040(4). Under RCW 21.20.040(4), persons may not use the titles “financial planner” or “investment counselor,” or terms deemed similar to them, unless they are registered as investment advisers or investment adviser representatives.

The amendments to WAC 460-24A-040 clarify that the list of terms similar to “financial planner” and “investment counselor” is not exclusive. To accomplish this, the amended rule states that any combination of terms similar to the terms in WAC 460-24A-040 may be deemed similar to “financial planner” and “investment counselor” if such terms are used to imply that the person is in the business of providing investment advisory or financial planning services.

Electronic Filing

WAC 460-24A-047, WAC 460-24A-060, and WAC 460-24A-205

The Securities Division amended WAC 460-24A-047, WAC 460-24A-060, and WAC 460-24A-205 to eliminate the paper filing of application materials. In our experience, most filers prefer to submit documents in electronic format rather than by postal mail. For many years, the Securities Division has required investment advisers to file application materials electronically through the Investment Adviser Registration Depository (IARD) operated by FINRA, except for those materials (such as balance sheets) which IARD does not accept. Advisers must file these materials directly with the Securities Division. To clarify filing procedures and eliminate paper filings, the amended rule provides that any materials which advisers cannot file on IARD must be filed with the Securities Division by email, or through a state electronic filing system to be developed in the future.

Examination Requirements

WAC 460-24A-050

The Securities Division adopted amendments to the examination requirements at WAC 460-24A-050 in order to incorporate FINRA’s new Securities Industry Essentials Exam (SIE). Previously, the Securities Division required investment advisers and investment adviser representatives in Washington to demonstrate that they had passed either the Series 65 exam; or both the Series 7 and Series 66 exam. However, as of October 1, 2018, FINRA now requires persons to pass the SIE before they are eligible to sit for the Series 7 exam.

Accordingly, the Securities Division amended WAC 460-24A-050 to specify that persons who satisfy the examination requirements by passing the Series 7 and the Series 66 examinations must now pass the SIE examination as well. This requirement does not apply if a person is currently registered as an investment adviser or investment adviser representative, or has been registered within the two-year period prior to the date of application. In addition, persons who satisfy the examination requirements by passing the Series 65 do not need to pass the SIE exam.

Registration Requirements

WAC 460-24A-050 and WAC 460-24A-205

The Securities Division adopted amendments to the registration requirements at WAC 460-24A-050 and WAC 460-24A-205 in order to require investment advisers to file a complete list of all custodians of the adviser’s separately managed accounts. Section 5.K.(3) of Schedule D of Form ADV Part 1A requires investment advisers who provide supervisory or management services to separately managed accounts to identify the custodians who hold 10% or more of the adviser’s aggregate separately managed account regulatory assets under management. However, this

creates a gap wherein the Securities Division may not have a full record of every custodian used by an investment adviser for separately managed accounts. For that reason, the Securities Division amended its rules to require advisers to file a complete list of custodians.

Advisers may satisfy the new requirement by disclosing *all* custodians on Schedule D of Form ADV Part 1A (regardless of the percentage of the adviser's aggregate separately managed account regulatory assets under management held by the custodian), or by separately submitting a complete list of custodians to the Securities Division.

Renewal Applications
WAC 460-24A-057

The Securities Division amended the renewal application provisions at WAC 460-24A-057 to specify that investment advisers and investment adviser representatives must submit renewal applications on IARD or CRD no later than the renewal application deadline set annually by FINRA. While the Securities Division's registration expiration date is December 31 each year, FINRA generally sets the renewal filing deadline a week or two earlier, and IARD will not accept filings after its deadline passes. The amendment therefore clarifies the application process.

Disqualification for Private Fund Adviser and Venture Capital Fund Adviser Exemptions
WAC 460-24A-071 and WAC 460-24A-072

The Securities Division amended the private fund adviser exemption at WAC 460-24A-071 and the venture capital fund adviser exemption at WAC 460-24A-072 to remove a reference to the disqualification provisions under Regulation D Rule 505 and replace it with a reference to disqualification provisions under Regulation D Rule 506. In 2017, the U.S. Securities and Exchange Commission repealed its Regulation D Rule 505 exemption. However, the disqualification provisions in Rule 506 are substantially similar to the disqualification provisions that were in Rule 505.

Advertisements
WAC 460-24A-100

WAC 460-24A-100 identifies certain advertising practices that constitute fraudulent or misleading practices under RCW 21.20.020. The Securities Division amended the rule to clarify that the fraudulent or misleading practices described in WAC 460-24A-100 are also considered fraudulent or misleading practices in the context of written communications directed to clients or prospective clients (even if such communications do not otherwise meet the definition of an "advertisement").

In addition, the Securities Division adopted within the rule its longstanding Securities Act Interpretive Statement 21 regarding the use of past performance data in advertisements by investment advisers, except that the Securities Division modified the Interpretive Statement in the adopted rule order to incorporate certain SEC guidance and practices. We also clarified that the provision of the client's actual account performance in an account statement generated by a

custodian is not subject to the disclosure requirements applicable to past performance data generally.

Finally, the Securities Division made various additions to the rule consistent with our current practices in reviewing investment adviser advertisements and written communications during field examinations. Accordingly, we amended WAC 460-24A-100 to provide that advertisements and written client communications must do the following:

- Contain the full legal name of the adviser;
- Provide a citation for any data or information referenced from outside sources;
- Refrain from including information inconsistent with the information provided on Form ADV or Form U4;
- Refrain from using the acronyms IA, IAR, and RIA unless the terms are defined; and
- Refrain from using senior designations in a manner inconsistent with Chapter 460-25A WAC.

Custody

WAC 460-24A-105

The Securities Division adopted amendments to WAC 460-24A-105, the rule that specifies the requirements for investment advisers who have custody of client funds or securities. WAC 460-24A-105 contains a provision that allows a client to designate an independent representative to receive the client's account statements for him or her. Due to concerns regarding potential conflicts of interest, the Securities Division amended WAC 460-24A-105 to prohibit an adviser from recommending a person to serve as the independent representative for a client.

Additional Custody Requirements/Fee Invoices

WAC 460-24A-106

WAC 460-24A-106 outlines the additional custody requirements that apply to investment advisers who directly deduct fees from client accounts. The rule requires these advisers to provide a fee invoice to clients. The Securities Division amended WAC 460-24A-106 to increase the amount of information available to clients on the fee invoice. The fee invoice must now contain the following additional information:

- The fee calculation;
- The name(s) of the custodian; and
- For advisers who charge performance fees:
 - The client's cumulative net investment gain or loss; and

- The amount of cumulative net investment gain above which the adviser will receive performance compensation (high-water mark).

Compliance Policies and Procedures
WAC 460-24A-120

The Securities Division amended the compliance policies and procedures rule at WAC 460-24A-120 in order to clarify which policies the Chief Compliance Officer must administer. The amended rule now specifies that the Chief Compliance Officer is responsible for administering the following:

- Compliance policies and procedures adopted pursuant to WAC 460-24A-120(1);
- Material nonpublic information policies and procedures adopted pursuant to WAC 460-24A-122;
- Proxy voting policies and procedures adopted pursuant to WAC 460-24A-125;
- Business continuity and succession plan adopted pursuant to WAC 460-24A-126;
- Supervision procedures adopted pursuant to WAC 460-24A-200(1)(t);
- Code of ethics adopted pursuant to WAC 460-24A-200(1)(aa); and
- Physical and cybersecurity policies and procedures adopted pursuant to WAC 460-24A-200(1)(bb).

Material Non-Public Information Policies and Procedures
WAC 460-24A-122

The Securities Division adopted a new section, WAC 460-24A-122, which requires investment advisers to adopt written policies and procedures designed to prevent the misuse of material non-public information by the investment adviser or any associated person of the adviser. This rule is based on Section 204A of the Investment Advisers Act of 1940. Previously, this requirement appeared solely in the unethical business practices rule at WAC 460-24A-220(17). The Securities Division adopted this requirement as a stand-alone rule in order to highlight its importance.

Business Continuity and Succession Plan
WAC 460-24A-126

The Securities Division adopted a new section at WAC 460-24A-126 that requires investment advisers to adopt a written business continuity and succession plan. Previously, the requirement for a business continuity plan was located solely in the recordkeeping rule at WAC 460-24A-(1)(y). The new rule conforms to the NASAA Model Rule on Business Continuity and

Succession Planning adopted by NASAA in 2015, and provides more guidance regarding the required contents of the business continuity and succession plan.

Advisory Contracts
WAC 460-24A-130

The Securities Division amended the investment advisory contract rule at WAC 460-24A-130 to make clarifications and to reflect the standards applied by our licensing unit during its review of advisory contracts. The amendments specify that an adviser must have a written advisory agreement with each client, and the agreement must include the full legal name of the investment adviser. In addition, the amendments add that the advisory contract must include the following statements:

- The adviser may not assign a contract through implied or negative consent;
- The adviser will deliver the brochure 48 hours before the client signs the advisory agreement, or alternately provide that the client has a right to terminate the contract within 5 business days;
- The adviser must obtain the consent of the client to revise material terms of the contract;
- The adviser owes the client a fiduciary duty; and if the investment adviser manages a pooled investment vehicle, each investor in the pooled investment vehicle is a client; and
- The contract may not waive the adviser's compliance with any rule adopted under the Securities Act of Washington.

The amendments to WAC 460-24A-130 formalize the requirements the Securities Division has routinely imposed on advisory contracts during the investment adviser licensing process. For that reason, the advisory contracts of most Washington-registered advisers currently meet the above requirements. In addition, the amended rules apply only to new or amended contracts entered into by the adviser after the effective date of the rule amendments.

Fee Invoices – Advisers Who Do Not Directly Deduct Fees
WAC 460-24A-135

The Securities Division adopted a new section at WAC 460-24A-135 to codify existing Securities Act Policy Statement 21. This Policy Statement specifies that advisers who do not directly deduct fees (and are therefore not subject to the fee invoice requirements in WAC 460-24A-106) still must deliver fee invoices to clients. This requirement ensures that clients receive written fee invoices with sufficient information for them to understand the fees charged. The amendments vary from the requirements of Policy Statement 21 slightly by requiring the disclosure of additional information on the fee invoice consistent with the additional information required by the amendments to WAC 460-24A-106, as discussed above.

Brochure Rule
WAC 460-24A-145

The Securities Division amended the brochure rule at WAC 460-24A-145 in order to reflect current SEC rules and guidance. Consistent with SEC Rule 204-3(b)(4), the amendments specify when an investment adviser must provide other-than-annual delivery of the brochure. The amendments further specify that if the adviser delivers the brochure by means of a passive delivery system, such as a website or portal, the adviser must notify clients by email when the brochure becomes available on the system.

Performance Compensation Arrangements
WAC 460-24A-150

The Securities Division made several amendments to the performance compensation rule at WAC 460-24A-150. Consistent with the current federal definition, the Securities Division updated the definition of “qualified client” to raise the net worth requirement for a natural person from \$2 million to \$2.1 million.

In addition, the Securities Division amended the performance compensation formula provisions at WAC 460-24A-150(3) to reflect the Securities Division’s current practices with respect to reviewing advisory contracts and the advisory fees contained therein. The Securities Division amended the performance compensation provisions at WAC 460-24A-150(3) as follows:

- The amendments removed the requirement that prohibited the adviser from calculating performance fees for a period of less than one year. The amendments substituted a requirement that the adviser not calculate the fee more frequently than once per quarter;
- The amendments added a statement to the effect that when a client invests mid-period in a pooled investment vehicle managed by the adviser, the adviser may apply the compensation formula to that client for the partial period; and
- The amendments added a requirement for a high-water mark.

Training Regarding Financial Exploitation of Vulnerable Adults
WAC 460-24A-190

The Securities Division adopted a new rule section at WAC 460-24A-190 in order to remind advisers of the existing requirement under RCW 74.34.220 to provide training to employees concerning financial exploitation of vulnerable adults.

Code of Ethics
WAC 460-24A-200(1)(aa)

The Securities Division adopted a new subsection at WAC 460-24A-200(1)(aa) which requires investment advisers to adopt a written code of ethics that establishes standards of business conduct which reflect the fiduciary obligations of the investment adviser and its supervised

persons. This requirement is consistent with the code of ethics required of federal advisers at SEC Rule 204A-1.

Physical and Cybersecurity Policies and Procedures
WAC 460-24A-200(1)(bb)

The Securities Division adopted a new subsection at WAC 460-24A-200(1)(bb) to require investment advisers to maintain written cybersecurity policies and procedures that are reasonably designed to ensure the security and integrity of the adviser's physical and electronic records. The Securities Division has consistently interpreted its existing compliance policies and procedures rule at WAC 460-24A-120 to require advisers to address physical and cybersecurity matters. However, due to the importance of the protection of client information, the Securities Division has now explicitly adopted a requirement for physical and cybersecurity policies and procedures.

Books and Records
WAC 460-24A-200

The Securities Division adopted several amendments to the books and records rule at WAC 460-24A-200. The amendments:

- Remove the requirement that the adviser retain "original" records of written client communications and instead specify that the adviser must retain "physical or electronic" records;
- Add a requirement that the adviser retain documentation of the client's authorization for each non-discretionary transaction;
- Specify the type of client profile information the adviser must maintain in order to determine suitability, and state that the adviser must make a reasonable effort to update this information annually;
- Specify that the adviser must retain written fee billing information and a written record of the services provided to clients during the billing period;
- Clarify that the adviser must provide state examiners access to electronic records and data;
- Add a requirement to maintain a code of ethics (discussed above); and
- Add a requirement to maintain physical and cybersecurity policies and procedures (discussed above).

Unethical Business Practices
WAC 460-24A-220

The Securities Division adopted amendments to the unethical business practices rule in WAC 460-24A-220. The amendments add that it is an unethical practice to do any of the following:

- Access a client’s account using the client’s own unique identifying information (such as username and password);
- Fail to provide advisory fee billing information pursuant to the new requirement in WAC 460-24A-135;
- Fail to establish, maintain, and enforce policies and procedures pursuant to WAC 460-24A-120, WAC 460-24A-122, WAC 460-24A-125, WAC 460-24A-126, WAC 460-24A-200(1)(t), WAC 460-24A-200(1)(aa), and WAC 460-24A-200(1)(bb);
- Fail to provide the training regarding the financial exploitation of vulnerable adults as required by the new section at WAC 460-24A-190.

Plain English Updates

The amendments revise Chapter 460-24A WAC to make Plain English changes and promote clarity and uniformity. For instance, the amendments eliminate the use of “shall” in the rules. The amendments also revised the rules to use consistent terminology throughout, to use active voice when feasible, and to alphabetize the definitions rule at WAC 460-24A-005.

Questions

In the coming months, the Securities Division intends to conduct several informational sessions across the state regarding the amended rules. You may also direct questions at any time to the Securities Division’s Licensing Unit at IALicensing@dfi.wa.gov.